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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1942

No. 842

E. A. PARKFORD,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

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Subject Index

	Page
Opinion Below	2
Jurisdiction	2
Statutes Involved	2
Question Presented	3
Statement of the Case	3
Specification of Errors to be Urged	6
Reason Why Writ Should be Granted	6
The Circuit Court of Appeals decided an important question of federal law which has not been, but should be settled by this court	6
Conclusion	12

Table of Authorities Cited

Cases

	Pages
Brown, In re, 4 Fed. (2d) 806	8, 9
Helvering v. Horst, 311 U. S. 112	10
Liebowitz, In re, 93 Fed. (2d) 333	9
Russell v. Commissioner, 35 B. T. A. 602	10
Wright, In re, 157 Fed. 544	8

Codes and Statutes

Bankruptcy Act of 1898, Section 70, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840	2, 8
Judicial Code, Section 240(a), as amended by Act of February 13, 1925	2
Revenue Act of 1936, c. 690, 49 Stat. 1648	2
Revenue Act of 1936:	
Sections 11, 12	6
Section 22	2
Section 41	2
Section 42	2
Section 48	2
Section 142(a)	2, 7
11 U. S. C. A. 110	8

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To the Honorable Harlan F. Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioner, E. A. Parkford, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on January 19, 1943.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is reported in ..... Fed. (2d) ..... (R. 345.)

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 19, 1943. Petition for rehearing therein was denied on February 16, 1943.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATUTES INVOLVED.

The statutes involved are the applicable sections of the Revenue Act of 1936, c. 690, 49 Stat. 1648. They are Section 22 defining gross income, Sections 41 and 42 relating to methods of accounting, Section 48 defining the taxable year and the meaning of the phrases "paid or accrued" and "paid or incurred", and Section 142a relating to fiduciary returns. Also involved is Section 70 of the Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840. Applicable excerpts therefrom will be found in the appendix.

QUESTION PRESENTED.

Did the Circuit Court of Appeals err in deciding, in a case of first impression, that a bankrupt is required to account for income paid directly to the trustee of his bankrupt estate, which income he never received and never could have received? The Circuit Court required the bankrupt to account for such income, even though it accrued after bankruptcy, and was paid directly to his trustee in bankruptcy pursuant to a final order made and entered in the bankruptcy proceeding. Thus, it has decided an important question in the administration of the Revenue Acts not heretofore decided by this Court or any other Court as to the scope and effect of these statutes where bankruptcy intervenes during the taxable year. An erroneous policy in the administration of the Revenue and Bankruptcy Acts has been adopted, vitally affecting thousands of future proceedings, and it should be corrected and settled by this Court.

STATEMENT OF THE CASE.

Petitioner, during the years 1935 and 1936, filed his income tax returns on the accrual basis. In 1935 he was endeavoring to settle a controversy between Universal Consolidated Oil Company and the Receiver of Richfield Oil Company, and a controversy between Associated Oil Company and one Guiberson. He was the owner of substantial properties and toward the end of the year 1935 was heavily indebted, chiefly by virtue of his ownership of such properties. (R. 64-65.)

As a result of petitioner's indebtedness and on January 24, 1936, an involuntary petition in bankruptcy was filed against petitioner in the United States District Court for the Southern District of California and on February 14, 1936 petitioner was adjudicated a bankrupt. (R. 67.) On January 24, 1936 one Robert Bromberg was appointed Receiver of petitioner's estate in bankruptcy and on March 23, 1936 Bromberg was appointed trustee of the bankrupt estate. Bromberg was authorized by the Bankruptcy Court to conduct, and did conduct, the business of the bankrupt in the operation of the bankrupt's properties. In connection with such operations he filed reports of his conduct of said business and such reports were approved by the Bankruptcy Court. (R. 88.) For the calendar year 1936, as trustee and receiver in bankruptcy, he filed an income tax return in the office of the Collector of Internal Revenue for the Sixth Collection District of California in Los Angeles, and in that return included as items of income or capital gain received by the trustee in bankruptcy, 6000 shares of Universal Consolidated Oil Company stock received by him from Universal Consolidated Oil Company and the sum of $7500.00 received by him from the Associated Oil Company (R. 189) (out of a total fee of $15,000.00, one-half of which was received by and accounted for by petitioner). The shares of Universal Consolidated Oil Company and the sum of $7500.00 hereinabove referred to were delivered and paid directly to Bromberg by the Universal Consolidated Oil Company and

the Associated Oil Company and never in any manner were in the hands of or passed through the hands of petitioner. (R. 67-68.)

With respect to the $7500.00 Associated Oil Company fee, the Board of Tax Appeals and the Circuit Court of Appeals for the Ninth Circuit found that the right to receive this sum was contingent upon the successful completion of services to be rendered by petitioner, which services were completed after bankruptcy, and that the right to receive the full fee of $15,000.00 did not accrue until after bankruptcy. (R. 40-41, 348.) After the fee had accrued, the trustee in bankruptcy claimed the entire amount of $15,000.00 and the amount thereof was deposited in escrow. After a hearing in the Bankruptcy Court and as a result of an order of the Court, petitioner received one-half of this amount and the trustee the remainder. The petitioner included the $7500.00 thus received by him in his return for 1936. (R. 69-70.) The Board of Tax Appeals and the Circuit Court of Appeals have held that petitioner is also required to account for the $7500.00 received by his trustee in bankruptcy.

Although petitioner strenuously urged upon the Board and the Circuit Court of Appeals that the right to receive the 6000 shares of the Universal Consolidated Oil Company stock accrued to him in 1935, the Board of Tax Appeals and the Circuit Court of Appeals have found that the right to receive the shares accrued on January 15, 1936, nine days prior to the filing of the involuntary petition in bankruptcy against petitioner. Admitting that the right to re-

ceive these shares accrued nine days prior to bankruptcy the evidence is undisputed, and the Board and Circuit Court so found, that neither the shares nor the proceeds derived from their sale by the trustee in bankruptcy were ever at any time received by the petitioner. On petition of the trustee, the Bankruptcy Court ordered the Universal Consolidated Oil Company to deliver the shares directly to the trustee and this was done.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred in holding that a bankrupt must account for income which accrued subsequent to bankruptcy and which he did not receive and never could have received, and that he must account for income accruing in the taxable year prior to bankruptcy which he did not receive and never could have received.

REASON WHY WRIT SHOULD BE GRANTED.

THE CIRCUIT COURT OF APPEALS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE SETTLED BY THIS COURT.

There is no section of the Revenue Act and there is no indication anywhere in the Revenue Act that a taxpayer, either on the cash or accrual basis, shall be required to account for income which he could not and did not receive.

Sections 11 and 12 of the Revenue Act of 1936 impose a tax upon the net income of every individual.

Section 142(a) of the said Act requires every fiduciary to make under oath a return for any individual, trust or estate for which he acts, stating specifically the items of gross income and the deductions and credits allowed under the Act. This, Bromberg, the trustee did. (R. 189, Ex. 3.) Income is taxed only to the person who receives or becomes entitled to receive the same. There is not the slightest indication in the Act that Congress intended to tax an individual upon income received by his trustee in bankruptcy. There is every indication that under the sections cited above Congress did intend to tax such income to the trustee who received the same, and who in this case accounted for the income in the return filed by him. (R. 189, Ex. 3.) Any tax payable by the trustee arising out of income received by him is, of course, an expense of administration, as distinguished from a provable claim against the estate, which must arise out of transactions of the bankrupt prior to bankruptcy. The taxing of this income to the trustee, so far as the fiscus is concerned, is the proper result of putting the duty of payment upon the person who is in possession of the assets with which to pay the tax. In practical effect, to hold that this income goes to the trustee free of a claim for taxes against the trustee, and that the income is taxable to the bankrupt who presumably is without funds and who has been deprived of the fund upon which the tax is imposed, is to deprive the government of the very source from which the tax can be collected. The debts of petitioner were not paid with these funds; they were discharged by virtue of the operations of the Bank-

ruptcy Act. Petitioner made no attempt whatsoever to reduce his taxes by any anticipatory voluntary arrangement. To hold that the income is that of petitioner and not of the trustee and that the tax liability is imposed upon the petitioner, even though the res passes to the trustee, is to adopt a so-called "practical" construction of the taxing Act which in most cases would result in a complete loss of Revenue to the Government, and would defeat the remedial purposes of the Bankruptcy Act.

The Circuit Court of Appeals held that petitioner's right to receive the sum of $15,000.00 from Associated Oil Company accrued to petitioner after bankruptcy. The Court then held that the trustee received one-half of this sum, either because it was property of the bankrupt passing to the trustee under the terms of the Bankruptcy Act or because petitioner voluntarily released a portion of this fee to the trustee.

The trustee had a right to receive the $7500.00, not because Parkford had any right to receive this compensation prior to bankruptcy (i. e., because it accrued before bankruptcy) but because the Bankruptcy Court determined that Parkford's right was the type of right which passed to the trustee in bankruptcy. A contract right passes to a trustee in bankruptcy, even though at the date of filing the bankruptcy petition no right to receive income has accrued and even though a right to receive income therefrom may never accrue. (Bankruptcy Act, Section 70, as amended.)

11 *U. S. C. A.* 110;
In re Wright, 157 Fed. 544;
In re Brown, 4 Fed. (2d) 806.

In the case of *In re Brown,* supra, the Court did just as the Bankruptcy Court did in Parkford's case, i. e., having determined that the compensation could be divided between the services rendered prior to bankruptcy and those rendered subsequent thereto, it did so divide such compensation between the trustee in bankruptcy and the bankrupt. This procedure was recognized in *In re Liebowitz,* 93 Fed. (2d) 333 (cited by the Board of Tax Appeals, Tr. p. 48) although the Court in that case was unable to make such segregation.

Rightly or wrongly, and viewing the transaction in retrospect, a Court of competent jurisdiction held that Parkford had a property right in one-half of the $15,000.00 fee at the date of the filing of the bankruptcy petition, notwithstanding that at that date his services had not been completed. The effect of this determination was to vest this property right in the trustee. Since Parkford's right to receive payment from the Associated Oil Company was wholly contingent upon the successful completion of his services, the property right acquired by the trustee in bankruptcy was valueless at date of bankruptcy and accordingly, its basis in the trustee's hands was zero. When, subsequently, the trustee realized $7500.00 on the right which he acquired, the entire $7500.00 constituted taxable income to the trustee and not to Parkford.

Neither the Universal Consolidated Oil Company stock nor the $7500.00 fee was voluntarily paid over to the trustee in bankruptcy. Petitioner resisted the

attempt of the trustee to secure these funds and it was by virtue of an order of Court made in the bankruptcy proceeding that the trustee obtained possession of the stock and of one-half of the Associated Oil fee.

Cases such as *Helvering v. Horst,* 311 U.S. 112, et seq., cited by the Court (R. p. 350) concern themselves with anticipatory arrangements by which transferors endeavored to be relieved of tax liability and have no bearing whatsoever upon this case.

Although the Court held that the right to receive the Universal shares accrued to petitioner prior to bankruptcy, during the taxable year 1936 it was ascertained that petitioner would never receive these shares. The situation is similar to the situation in which an individual on a cash basis is required to repay salary previously paid to him during the taxable year. The taxable year is looked upon as an entity and petitioner is required to account only for that which he retains. See *Russell v. Commissioner,* 35 B.T.A. 602. Similarly, on the accrual basis, petitioner should not be required to account for income during the taxable year when it is known during that year that he never will receive it.

In the last analysis the decision of the Circuit Court of Appeals rests upon the idea of the Court that since the proceeds of the Universal shares and the $7500.00 fee went to the creditors of petitioner, they were used to pay petitioner's debts, and he therefore should account for them. It is, of course, elementary that bankruptcy discharges obligations of the bankrupt by

virtue of the operation of the remedial provisions of the Bankruptcy Act itself. Whether the bankrupt's assets are sufficient to pay nothing whatsoever, or 100 cents on the dollar, is entirely immaterial. The policy of the law to permit a discharge of an overwhelming burden of debt is effectuated by statutory discharge. The basis of the decision therefore is fallacious.

Whatever rights, however inchoate, vested in petitioner as a result of services rendered by him, under bankruptcy law, went to his trustee in bankruptcy coincident with the commencement of the bankruptcy proceeding. The trustee was by the Court vested with the power and authority to continue to conduct the bankrupt's business and did so. The trustee while conducting the bankrupt's business received the fruits of the bankrupt's services along with other income during the process of operating the bankrupt's business and accounted in his income tax return therefor. It is inconceivable that under a "practical construction" of the taxing statutes, the law should deprive the bankrupt of the fruits of his services, transfer them to the trustee, require the trustee to account for them under taxing laws but foist the burden of payment upon the bankrupt.

The decision herein is a case of first impression in this Court and so far as known to petitioner, has never been determined by any other Federal or State Court. The question presented is of extreme importance in the administration of the Revenue Acts and should be finally determined by this Court.

CONCLUSION.

It is respectfully submitted that this petition should be granted.

Dated, San Francisco, California,
March 15, 1943.

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(Appendix Follows.)